

CONFIDENTIAL

FM BONN

TO IMMEDIATE FCO

TELNO 883

OF 151250Z SEPTEMBER 89

INFO ROUTINE PARIS, ROME, BRUSSELS, LUXEMBOURG, THE HAGUE, OTTAWA
INFO ROUTINE UKREP BRUSSELS, UKDEL OECD, WASHINGTON, TOKYO
INFO SAVING CGS IN THE FRG AND BERLIN, BMG BERLIN

FRAME ECONOMIC

MIPT (NOT TO ALL): FRG ECONOMY

SUMMARY

1. FRG ECONOMY GROWING STRONGLY. UNEMPLOYMENT CONTINUES TO FALL AND INFLATION TO EASE. MASSIVE TRADE SURPLUS. POLICY INITIATIVES UNLIKELY BEFORE ELECTION IN DECEMBER 1990.

ECONOMIC DEVELOPMENTS

2. THE SECOND QUARTER NATIONAL ACCOUNTS RELEASED ON 7 SEPTEMBER SHOWED CONTINUED STRONG EXPANSION, BRINGING GROWTH IN THE FIRST HALF OF THE YEAR TO 4.6 PER CENT IN REAL TERMS, THE HIGHEST FOR 13 YEARS. THE MAIN SOURCES OF GROWTH WERE INVESTMENT, PARTICULARLY CAPITAL INVESTMENT BY INDUSTRY, AND EXPORTS. THE FIGURES FOR AUGUST SHOW UNEMPLOYMENT STILL BELOW 2 MILLION, DESPITE THE INFLUX OF REFUGEES FROM THE GDR AND EASTERN EUROPE, I.E. EMPLOYMENT HAS CONTINUED TO RISE. INFLATION EASED BACK BELOW 3 PER CENT IN AUGUST IN RESPONSE TO A RESTRICTIVE MONETARY POLICY WHICH HAS BROUGHT THREE INTEREST RATE RISES IN 12 MONTHS.

FOREIGN TRADE

3. IN THE FIRST SEVEN MONTHS OF THE YEAR THE TRADE SURPLUS REACHED DM 80.9 BILLION, DM 10.6 BILLION HIGHER THAN A YEAR EARLIER. TRADE WITH EC PARTNERS, PARTICULARLY FRANCE, ITALY AND THE UK, GREW MOST STRONGLY. IN THE SIX MONTHS TO JUNE EXPORTS TO THE UK ALONE ROSE BY OVER 20 PER CENT WHILE IMPORTS INCREASED BY AROUND 15 PER CENT, PRODUCING A TRADE GAP IN FAVOUR OF THE FRG OF DM 13.5 BILLION. IN A RECENT INTERVIEW BUNDESBANK PRESIDENT POEHL COMMENTED THAT THE FRG'S TRADE IMBALANCE WITH OTHER EUROPEAN COUNTRIES WOULD JUSTIFY A REALIGNMENT OF THE MARK, BUT THIS WOULD NOT HAPPEN SINCE THE FRENCH HAD RULED IT OUT.

FISCAL POLICY

4. FINANCE MINISTER WAIGEL EMPHASISED THE STRENGTH OF THE ECONOMY WHEN HE LAUNCHED THE DRAFT BUDGET IN PARLIAMENT ON 4 SEPTEMBER. IN A CONFIDENT PERFORMANCE HE ATTRIBUTED THE SUCCESS TO THE GOVERNMENT'S POLICIES OF DEREGULATION AND TAX REFORM. OUTLINING A 3.4 PER CENT INCREASE IN FEDERAL SPENDING, HE BRUSHED ASIDE OPPOSITION COMPLAINTS THAT THE GOVERNMENT HAD LOOSENED THE REINS ON FISCAL POLICY BY ALLOWING FEDERAL BORROWING TO INCREASE TO DM 33.7 BILLION NEXT YEAR IN ORDER TO FINANCE FURTHER TAX CUTS. NEVERTHELESS, THE PROPOSED BUDGET DEFICIT HAS LED TO CRITICISM FROM SOME QUARTERS.

PROSPECTS

5. THE GOVERNMENT CAN JUSTIFIABLY BE SATISFIED WITH THE UNEXPECTEDLY HIGH GROWTH OF THE ECONOMY. GNP IS GENERALLY FORECAST TO AVERAGE 4 PER CENT REAL GROWTH THIS YEAR, UNEMPLOYMENT MAY DIP FURTHER AND INFLATION APPEARS TO HAVE PEAKED AS THE GOVERNMENT PREDICTED. ALTHOUGH THERE IS GROWING EVIDENCE OF CAPACITY BOTTLENECKS IN SOME SECTORS, PARTICULARLY SKILL SHORTAGES, AND POSITIONS ARE BEING STAKED OUT FOR A DIFFICULT WAGE ROUND IN WHICH CLAIMS FOR HIGHER PAY AND SHORTER WORKING HOURS MAY SQUEEZE PRODUCTIVITY, THESE PROBLEMS ARE MANAGEABLE. IN THE RUN UP TO THE ELECTION IN DECEMBER 1990 THE FEDERAL GOVERNMENT SEEMS SET TO CAMP ON ITS ECONOMIC RECORD, AND EXPERIMENTS ARE UNLIKELY. THE POLICY OF DEREGULATION SEEMS TO HAVE RUN TEMPORARILY OUT OF STEAM AND THE GERMANS ARE NOT DISPOSED TO INTRODUCE THE KIND OF STRUCTURAL CHANGES WHICH WILL BE NEEDED TO REDUCE THE TRADE SURPLUS. 17

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